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ELLIOTT & ELLIOTT, P.A.
ATTORNEYS AT LAW
721 OLIVE STREET
COLUMBIA, SOUTH CAROLINA 29205
selliott@elliottlaw.us

SCOTT ELLIOTT

TELEPHONE (803) 771-0555
FACSIMILE (803) 771-8010

May 11, 2005

VIA HAND DELIVERY

Mr. Charles Terreni
Chief Clerk of the Commission
SC Public Service Commission
P. O. Drawer 11649
Columbia, SC 29211

CO
COMM
2005 MAY 11 PM 4:30
FBI

RE: Annual Review of Base Rates for Fuel Costs for Carolina Power
& Light Company d/b/a Progress Energy Carolinas, Inc.
Docket No. 2005-1-E

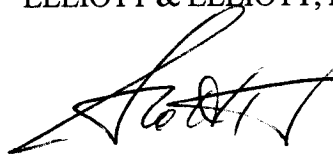
Dear Mr. Terreni:

Enclosed please find for filing an original and twenty-six (26) copies of the Direct Testimony of Kevin W. O'Donnell on behalf of the South Carolina Energy Users Committee ("SCEUC") in the above-captioned matter, one copy I would request that you date stamp and return to me via my courier. By copy of this letter, I am serving all parties of record.

If you have questions, please feel free to contact me.

Sincerely Yours,

ELLIOTT & ELLIOTT, P.A.



Scott Elliott

SE/jcl
Enclosures

cc: All parties of record (w/enc.)

CERTIFICATE OF SERVICE

The undersigned employee of Elliott & Elliott, P.A. does hereby certify that (s)he has served below listed parties with a copy of the pleading(s) indicated below by mailing a copy of same to them in the United States mail, by regular mail, with sufficient postage affixed thereto and return address clearly marked on the date indicated below:

RE: Carolina Power & Light Company d/b/a Progress Energy
Carolinas, Inc. Annual Review of Base Rates for Fuel Costs

DOCKET NO.: 2005-1-E

PARTIES SERVED: Florence P. Belser, Esquire
ORS
1441 Main Street, Ste. 300
Columbia, SC 29201

Len S. Anthony, Manager
Regulatory Affairs
Progress Energy Services Company
P. O. Box 1551/PEB 17A4
Raleigh, NC 27602-1551

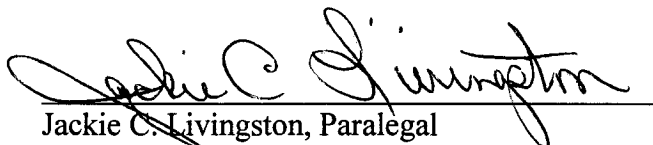
Thomas S. Mullikin, Esquire
Moore & Van Allen, PLLC
100 N. Tryon Street, Ste. 4700
Charlotte, NC 28202

Wendy Cartledge, Esquire
ORS
1441 Main Street, Ste. 300
Columbia, SC 29201

Garrett A. Stone, Esquire
Brickfield, Burchette, Ritts & Stone
1025 Thomas Jefferson Street, N.W.
8th Floor, West Tower
Washington, DC 20007

PLEADING: DIRECT TESTIMONY OF KEVIN W. O'DONNELL BY
SOUTH CAROLINA ENERGY USERS COMMITTEE

May 11, 2005


Jackie C. Livingston, Paralegal

SO FILED
COMMISSION
2005 MAY 11 PM 4:32
REC-1070

State of South Carolina

Before the

South Carolina Public Service Commission

ORIGINAL
FILED
2005/12/15

In the Matter of:

Application of Carolina Power & Light

Company d/b/a Progress Energy

Carolinas, Inc. for an Adjustment of its

Rates and Charges

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)
)
)
)

Docket No. 2005-1-E

Prepared Direct Testimony

of

Kevin W. O'Donnell, CFA

FILED
2005 MAY 11 PM 11:22
SOUTH CAROLINA
PUBLIC SERVICE COMMISSION

On Behalf of the

South Carolina Energy Users Committee

RETURN DATE: 11/11/05
SERVICE: OK DW

May 11, 2005

1 **Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS**
2 **FOR THE RECORD.**

3 A. My name is Kevin W. O'Donnell. I am President of Nova Energy Consultants,
4 Inc. My business address is 1350 Maynard Rd., Suite 101, Cary, North Carolina
5 27511.
6

7 **Q. ON WHOSE BEHALF ARE YOU PRESENTING TESTIMONY IN THIS**
8 **PROCEEDING?**

9 A. I am testifying on behalf of the South Carolina Energy Users Committee
10 (SCEUC), an association of manufacturers active in many proceedings before the
11 South Carolina Public Service Commission (the PSC or the Commission). Many
12 of SCEUC's members take service from Carolina Power & Light (CP&L).
13

14 **Q. PLEASE OUTLINE YOUR EDUCATIONAL BACKGROUND AND**
15 **RELEVANT EMPLOYMENT EXPERIENCE.**

16 A. I received a B.S. degree in Civil Engineering - Construction Option from North
17 Carolina State University in May of 1982 and a Masters of Business
18 Administration in Finance from Florida State University in August of 1984.
19

20 In September of 1984, I joined the Public Staff of the North Carolina Utilities
21 Commission as a Public Utilities Engineer in the Natural Gas Division. In
22 December of 1984, I transferred to the Public Staff's Economic Research Division
23 and held the position of Public Utility Financial Analyst. In September of 1991, I
24 joined Booth & Associates, Inc., a Raleigh, North Carolina, based electrical
25 engineering firm, as a Senior Financial Analyst. I stayed in this position until
26 June 1994, when I accepted employment as the Director of Retail Rates for the
27 North Carolina Electric Membership Corporation. In January 1995, I formed
28 Nova Utility Services, Inc., an energy consulting firm. In May of 1999, I changed
29 the name of Nova Utility Services, Inc. to Nova Energy Consultants, Inc. I am a
30 Chartered Financial Analyst (CFA) and a member of the Association of
31 Investment Management and Research.

1
2 I am also a senior financial analyst with MAKROD Investment Associates, which
3 is a money management firm based in Verona, New Jersey.
4

5 I have testified before the North Carolina Utilities Commission in the following
6 general rate case proceedings: Public Service Company of North Carolina, Inc.
7 (Docket No. G-5, Sub 200, Sub 207, Sub 246, Sub 327, and Sub 386); Piedmont
8 Natural Gas Company (Docket No. G-9, Sub 251 and Sub 278); General
9 Telephone of the South (Docket No. P-19, Sub 207); North Carolina Power
10 (Docket No. E-22, Sub 314); Piedmont Natural Gas Company (Docket No. E-7,
11 Sub 487); Pennsylvania & Southern Gas Company (Docket No. G-3, Sub 186);
12 and in several water company rate increase proceedings. I also submitted pre-filed
13 testimony, and/or assisted in the settlement process, in Docket Nos. G-9, Sub 378,
14 Sub 382, Sub 428 and Sub 461, which were general rate cases involving Piedmont
15 Natural Gas Company; in Docket No. G-21, Sub 334, North Carolina Natural Gas'
16 most recent general rate case; in Docket No. G-5, Sub 356, Public Service of
17 North Carolina's 1995 general rate case; and in Docket No. G-39, Sub 0, Cardinal
18 Extension Company's rate case. Furthermore, I testified in the 1995 fuel
19 adjustment proceeding for Piedmont Natural Gas Company (Docket No. E-2, Sub
20 680) and submitted pre-filed testimony in Docket No. E-7, Sub 559, which was
21 Piedmont Natural Gas Company's 1995 fuel adjustment proceeding. I also
22 submitted pre-filed testimony and testified in Duke's 2001 fuel adjustment
23 proceeding, which was Docket No. E-7, Sub 685.

24
25 Furthermore, I testified in Docket No. G-21, Sub 306 and 307, in which North
26 Carolina Natural Gas Corporation petitioned the Commission to establish a
27 natural gas expansion fund. I also submitted testimony in the Commission's 1998
28 study of natural gas transportation rates that was part of Docket No. G-5, Sub 386,
29 which was the 1998 general rate case of Public Service Company of North
30 Carolina. In September of 1999, I testified in Docket Nos. G-5, Sub 400 and G-
31 43, which was the merger case of Public Service Company of North Carolina and

1 SCANA Corp. I also submitted testimony and stood cross-examination in the
2 holding company application of NUI Corporation, a utility holding company
3 located in New Jersey, which was NCUC Docket No. G-3, Sub 224, as well as
4 NUI's merger application with Virginia Gas Company, which was Docket No. G-
5 3, Sub 232. I also submitted pre-filed testimony and stood cross-examination in
6 Docket No. G-3, Sub 235, which involved a tariff change request by NUI
7 Corporation. I testified in another holding company application in Docket No. E-
8 2, Sub 753; G-21, Sub 387; and P-708, Sub 5 which was the holding company
9 application of Piedmont Natural Gas. In June of 2001, I submitted testimony and
10 stood cross-examination in Docket No. E-2, Sub 778, which was CP&L's
11 application to transfer Certificates of Public Convenience and Necessity (CPCN)
12 from two of the Company's generating units to its non-regulated sister company,
13 Progress Energy Ventures. In November of 2001, I testified in Duke Energy's
14 restructuring application, which was Docket No. E-7, Sub 694. In January 2002, I
15 presented testimony in the merger application of Duke Energy Corp. and
16 Westcoast Energy. In April of 2003, I submitted testimony in Dockets Nos. G-9,
17 Sub 470, Sub 430, and E-2, Sub 825, which was the merger application of
18 Piedmont Natural Gas and North Carolina Natural Gas. In May of 2003, I
19 submitted testimony in the general rate case of Cardinal Pipeline Company, which
20 was Docket No. G-39, Sub 4. In July, 2003, I filed testimony in Docket No. E-2,
21 Sub 833, which was CP&L's 2003 fuel case proceeding.

22
23 In August of 2002, I submitted pre-filed testimony and stood cross-examination
24 before the South Carolina Public Service Commission in Docket No. 2002-63-G,
25 which was Piedmont's 2002 general rate case. In October of 2004, I submitted
26 pre-filed testimony and stood cross-examination in the general rate case of South
27 Carolina Electric & Gas. In March, 2005, I prepared pre-filed testimony and
28 assisted in the settlement involving the fuel application proceeding of South
29 Carolina Electric & Gas.

1 In May of 1996, I testified before the U.S. House of Representatives, Committee
2 on Commerce and Subcommittee on Energy and Power concerning competition
3 within the electric utility industry.

4
5 I am also very active in the wholesale power markets as my firm, Nova Energy
6 Consultants, Inc., is the electrical consultant for several municipalities in North
7 Carolina that purchase all of their power supplies on the open wholesale market. I
8 have also worked with North Carolina and South Carolina municipalities in
9 presenting comments to the Federal Energy Regulatory Commission regarding the
10 opening of the wholesale power markets in the Carolinas.

11
12 I have also published the following articles: Municipal Aggregation: The Future is
13 Today, *Public Utilities Fortnightly*, October 1, 1995; Small Town, Big Price Cuts,
14 *Energy Buyers Guide*, January 1, 1997; and Worth the Wait, But Still at Risk,
15 *Public Utilities Fortnightly*, May 1, 2000. All of these articles dealt with my
16 firm's experience in working with small towns that purchase their power supplies
17 in the open wholesale power markets.

18
19 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
20 **PROCEEDING?**

21 A. The purpose of my testimony is to review the requested fuel increase sought by
22 Carolina Power & Light (CP&L) in this case.

23
24 **Q. HOW IS YOUR TESTIMONY IN THIS CASE STRUCTURED?**

25 A. My testimony in this case is structured as follows:

- 26
27 I. Impact on South Carolina of CP&L's Fuel Increase Request
28 II. Analysis of CP&L Fuel Request
29
30

1 **I. Impact on South Carolina of CP&L's Fuel Increase Request**

2
3 **Q. WHAT IS YOUR OPINION OF THE COMPANY'S REQUESTED FUEL**
4 **INCREASE IN THIS CASE?**

5 A. My analysis of CP&L's fuel request in this proceeding is that the requested
6 increase is excessive, unsupported by the evidence presented by the Company's
7 witnesses in this proceeding, and, if allowed to stand, will harm all the utility's
8 customers in the state, particularly South Carolina manufacturers, and put a
9 tremendous strain on the economy of northeast South Carolina.

10
11 **Q. HOW MUCH OF AN INCREASE IS CP&L SEEKING IN THIS FUEL**
12 **PROCEEDING?**

13 A. In this case, CP&L is seeking to raise retail rates in its South Carolina service
14 territory by a stunning \$97 million per year. Of this increase, \$30 million
15 represents the amount of under-collection that CP&L has experienced through
16 March and another \$11 million undercollection is forecasted over the next three
17 months thereby resulting in a total undercollection of \$41 million. On a
18 percentage basis, this rate increase will raise overall rates to CP&L's residential
19 consumers by 16% and to its industrial consumers by approximately 27%.

20
21 **Q. MR. O'DONNELL, CAN YOU PLEASE PUT THESE PERCENTAGE**
22 **INCREASES INTO DOLLAR TERMS FOR THE TYPICAL CP&L**
23 **RESIDENTIAL CONSUMER?**

24 A. Yes. To make this calculation, I used information taken from the Energy
25 Information Administration (EIA) to calculate the average current cost of
26 electricity for residential and industrial consumers in CP&L's South Carolina
27 service territory. The latest information available, which is based on 2003 data, on
28 the EIA website indicates that the typical CP&L residential consumer pays the
29 utility \$1,222 per year for electric service. A 16% increase in the cost of power
30 will cost the typical South Carolinian an additional \$199 per year.

1 Similarly, the EIA relates that the typical CP&L industrial consumer pays the
2 utility close to \$200,000 per year for electric utility service. A 27% increase in
3 power costs will raise the annual expense for electric service to the typical South
4 Carolina industrial consumers by a stunning \$54,471 per year. In addition, as the
5 Commission is aware, small businesses create the majority of new jobs in our
6 economy. A proportionately similar increase to small businesses for electric
7 service will surely have a chilling effect on job creation.

8
9 Furthermore, based on my familiarity of this area, the above stated EIA numbers
10 understate the severity of the cost increase to large manufacturers. For example, a
11 large manufacturer that spends \$1 million per year for electricity will, assuming
12 CP&L's full request is approved, spend an additional \$270,000 per year for
13 electricity. Such an increase represents approximately six workers that might
14 otherwise have been hired by the manufacturer.

15
16 **Q. TO WHAT DOES THE COMPANY ATTRIBUTE THIS TREMENDOUS**
17 **INCREASE IN FUEL COSTS?**

18 A. According to the Company's pre-filed testimony, the price of natural gas and coal
19 has skyrocketed since CP&L's last fuel case one year ago. The Company clearly
20 under-forecasted these commodity price increases which has herein resulted in the
21 \$41 million under-collection in fuel costs that CP&L is seeking to recover in this
22 case.

23
24 **Q. CAN YOU PLEASE DESCRIBE THE STATE'S CURRENT**
25 **UNEMPLOYMENT OUTLOOK?**

26 A. South Carolina's current unemployment rate is the fourth highest in the United
27 States and the District of Columbia.

Table 1: State-by-State Unemployment Rankings

Ranking	State	Unemployment Rate
1	Hawaii	2.80%
2	Wyoming	3.10%
3	North Dakota	3.30%
4	Virginia	3.30%
5	Vermont	3.40%
6	New Hampshire	3.70%
7	South Dakota	3.70%
8	Delaware	3.90%
9	Nevada	3.90%
10	Nebraska	4.00%
11	Idaho	4.20%
12	Maryland	4.30%
13	New Jersey	4.30%
14	Florida	4.40%
15	Minnesota	4.40%
16	Oklahoma	4.40%
17	Rhode Island	4.50%
18	Montana	4.60%
19	New York	4.60%
20	Wisconsin	4.60%
21	Alabama	4.70%
22	Arizona	4.70%
23	Maine	4.70%
24	Utah	4.80%
25	Connecticut	4.90%
26	Massachusetts	4.90%
27	Georgia	5.00%
28	Colorado	5.10%
29	Iowa	5.10%
30	Arkansas	5.20%
31	North Carolina	5.20%

32	Washington	5.20%
33	West Virginia	5.20%
34	Kentucky	5.30%
35	Louisiana	5.30%
36	California	5.40%
37	Kansas	5.40%
38	Pennsylvania	5.40%
39	Illinois	5.60%
40	Indiana	5.60%
41	Texas	5.60%
42	Missouri	5.70%
43	New Mexico	5.90%
44	Tennessee	5.90%
45	Oregon	6.20%
46	Ohio	6.30%
47	Alaska	6.70%
48	South Carolina	6.80%
49	Michigan	6.90%
50	Mississippi	7.00%
51	District of Columbia	7.80%

Source for data: http://money.cnn.com/pf/features/lists/state_unemployment/

As can be seen in the above table, only Michigan, Mississippi, and the District of Columbia have higher unemployment rates than South Carolina. To say the least, South Carolinians are struggling mightily at a time when the United States economy is expanding.

Q. CAN YOU BE MORE SPECIFIC AND PROVIDE UNEMPLOYMENT INFORMATION FOR THE SECTION OF SOUTH CAROLINA SERVED BY CAROLINA POWER & LIGHT?

A. Yes. On the next page is a table that I compiled from the April, 2005 edition of *South Carolina Workforce Trends*.

**Table 2: Unemployment Rates in Service Territory
of Carolina Power & Light**

Ranking	County	Unemployment Rate
1	Marion	15.50%
2	Williamsburg	13.90%
3	Marlboro	13.20%
4	Georgetown	11.90%
5	Clarendon	11.30%
6	Chesterfield	11.00%
7	Dillon	10.90%
8	Sumter	10.80%
9	Lee	10.50%
10	Florence	8.40%
11	Kershaw	8.30%
12	Horry	7.70%
13	Darlington	7.00%
Average		10.80%

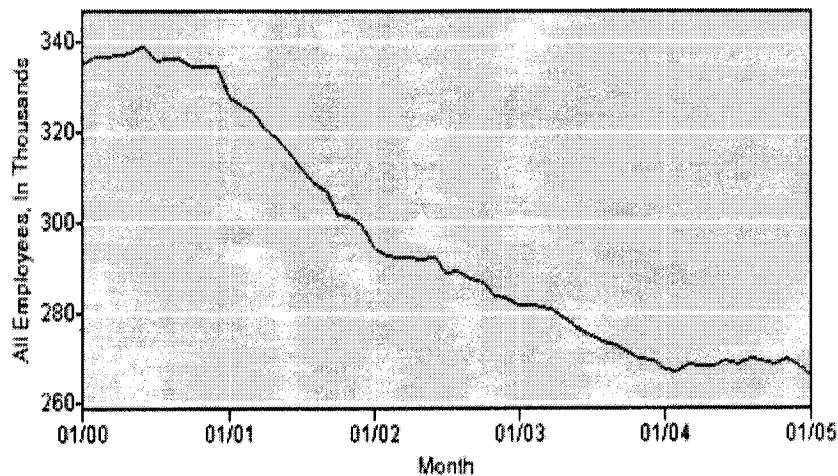
Source for data: South Carolina Workforce Trends, April, 2005

Sadly, it is readily apparent that the unemployment situation in the service territory of CP&L is much, much worse than the rest of the state. A simple average of the county unemployment rates in CP&L's service territory is 10.80%, which compares extremely poorly to the state unemployment rate of 6.8% and the national unemployment average of 5.2%. Put simply, the northeastern corner of the State of South Carolina is not experiencing the economic rebound felt in most other parts of the country as evidenced by the very high unemployment rates in these counties.

1 **Q. HOW MANY SOUTH CAROLINIANS HAVE LOST THEIR**
2 **MANUFACTURING JOBS IN THE PAST FIVE YEARS?**

3 A. Below is a graph that shows how South Carolina manufacturing has suffered over
4 the past five years.
5

6 **South Carolina Manufacturing Employment**
7 **from Jan., 2000 through Jan., 2005**



8
9 **Source of graph: U.S. Dept. of Labor, Bureau of Labor Statistics**

10
11 As can be seen in the above table, approximately 70,000 South Carolinians have
12 lost their jobs in the manufacturing sector. Considering that 340,000 individuals
13 made their living in the manufacturing sector at the start of this decade, roughly 1
14 out of every 5 South Carolina manufacturing employees have lost their jobs in the
15 past five years alone.

16
17 As sobering as the above graph and numbers are, it is important to also remember
18 the human toll of such layoffs. All too frequently, workers' financial and personal
19 lives are severely damaged as the result of layoffs.
20

21 **Q. HOW DOES THE STATE OF SOUTH CAROLINA SUFFER FROM SUCH**
22 **A CUTBACK FROM MANUFACTURERS?**

1 **A.** First, unemployment costs rise as manufacturers cut back further. Second, income
2 taxes fall as profits from manufacturers fall. South Carolina, like most other state
3 governments, struggles with budget problems. The double-hit of an increase in
4 unemployment payments coupled with the loss of corporate income taxes and
5 personal income taxes makes it very difficult for the state to balance its budget
6 without either raising taxes or cutting benefits and services to the state's citizens.

7
8 Local economies also suffer as unemployed workers cut back on expenses thereby
9 dragging the local economy down. If a manufacturing plant ceases operations, the
10 assessed value of the plant property will most likely fall which will then decrease
11 tax revenues to the county and municipal governments as well as the local school
12 districts, some of which are among the poorest in the state. Furthermore, vendors
13 often locate in close proximity to manufacturing facilities. If a large manufacturer
14 closes its doors, there is a strong possibility that some of the plant's vendors will
15 also cease operations thereby creating a ripple effect in the local and state
16 economies.

1 **II. Analysis of CP&L Fuel Request**

2

3 **Q. HAVE YOU REVIEWED CP&L'S CALCULATIONS USED IN THIS**
4 **CASE?**

5 A. Yes, I have.

6

7 **Q. DO YOU AGREE WITH CP&L'S FORECASTS USED IN THIS CASE TO**
8 **ESTABLISH ITS FORECASTED FUEL EXPENSES IN THE COMING**
9 **YEAR?**

10 A. No, I do not believe the fuel factor requested is appropriate, nor will it assure
11 public confidence in the utility's rates or minimize abrupt changes in the utility's
12 charges to its customers.

13

14 In his pre-filed testimony, CP&L witness Coats makes the following statement:

15

16 We project a need for 20.5 million decatherms for the period of
17 July 2004 through June 2005 at an average commodity cost of
18 \$8.89 /Dt and a delivered cost of \$10.21/Dt. (p. 19, l. 21-23)

19

20 I believe that Mr. Coats mistakenly used the past test year in the above sentence
21 and that the \$8.89/Dt forecast is actually the forecast for the coming test year of
22 July 2005 through June 2006. This price forecast of \$8.89/Dt was confirmed by
23 CP&L employees at a SCEUC meeting earlier this month at which this fuel
24 increase was discussed.

25

26 In my opinion, this price forecast of \$8.89/Dt is excessive and should be reduced.
27 Evidence for my belief that CP&L's forecasted gas price for the twelve months
28 ending June 30, 2006 can be seen in Table 3 below.

Table 3
Futures Price of Natural Gas

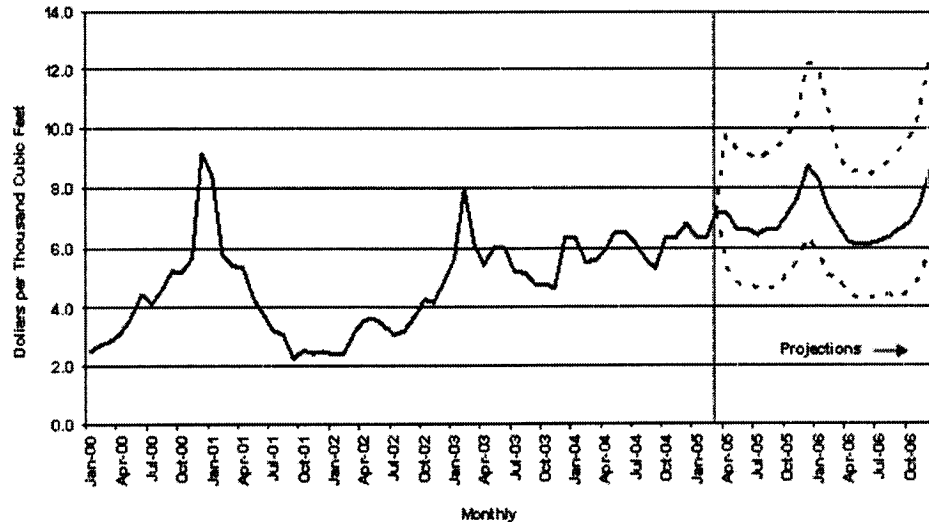
Year	Month	Futures Price
2005	July	\$6.774
	August	\$6.844
	September	\$6.892
	October	\$6.947
	November	\$7.387
	December	\$7.802
2006	January	\$8.057
	February	\$8.052
	March	\$7.912
	April	\$6.872
	May	\$6.747
	June	\$6.797

Source for data: The Wall Street Journal, May 10, 2005

As can be seen in the above table, the highest cost natural gas forecast for any month is \$8.057 per MMBTU, which can be found for the months of January, 2006. CP&L's price forecast of \$8.89 per MMBTU is, on the other hand, for a twelve-month period. Hence, CP&L's forecast for the coming 12 months is \$0.86 per MMBTU higher than the single highest monthly price currently reported in the financial markets. Furthermore, I examined the calendar year 2004 historical monthly variation of when CP&L purchases natural gas and calculated the weighted average cost of natural gas. This weighted average calculation was \$7.07 per MMBTU which, again, is significantly lower than CP&L's forecast of \$8.89.

The Energy Information Administration (EIA) also provides a short-term forecast of natural gas prices in its April, 2005 *Short-Term Energy Outlook*. Below is a graph of EIA's forecast for natural gas prices.

**Figure 9. U.S. Natural Gas Spot Prices
(Base Case and 95% Confidence Interval*)**



*The confidence intervals show ± 2 standard errors based on the properties of the model. The ranges do not include the effects of major supply disruptions.

Sources: History: Natural Gas Week; Projections: Short-Term Energy Outlook, April 2005



Except for a short period of time in the winter of 2006, EIA is forecasting base case natural gas prices to be below \$8.00 per dt for the coming twelve months. EIA's margin of error is represented by the dotted lines in the graph.

The EIA further states in its April, 2005 *Short-Term Energy Outlook*:

The Henry Hub natural gas spot price averaged over \$7.00 per thousand cubic feet (mcf) in March, compared to \$5.55 per mcf in March 2004. High crude oil prices, combined with the unusually cold March weather for much of the Nation, increased heating demand and boosted spot prices for natural gas to levels above \$7.00. Although spot prices for natural gas may dip during the spring and summer, natural gas supply conditions are expected to remain tight over the same period. Although natural gas storage remains adequate, high world oil prices, a continued strong economy, and the expectation that below-normal Pacific Northwest hydroelectric resources will be well below normal through mid-summer are the principal reasons for the upward revision of the natural gas price projections from last month's *Outlook*. Thus, Henry Hub prices are expected to remain relatively high, averaging about \$6.95 per mcf this year and \$6.90 in 2006.

1 All forecasts which I have been able to obtain indicate that CP&L's forecast of
2 \$8.89 per Dt natural gas is excessively high. If CP&L's forecast is too robust,
3 South Carolinians will pay unnecessarily high rates at a time when they are
4 already be asked to endure double-digit rate increases due to poor past commodity
5 forecasts.

6
7 CP&L should, at the very least, provide evidence to support its contention that
8 natural gas will cost an average of \$8.89 per Dt over the course of the twelve
9 months ending June 30, 2006. CP&L's pre-filed testimony in this proceeding
10 simply does not provide any compelling evidence to support the Company's
11 belief that natural gas will average \$8.89 per Dt in the coming year.

12
13 **Q. DO YOU HAVE ANY RECOMMENDATIONS TO THIS COMMISSION**
14 **IN REGARD TO CP&L'S FORECASTED COST OF COAL?**

15 A. Yes. In the testimony of Company witness Mr. Coats, it appears that CP&L is
16 claiming that it has recently been able to purchase coal at below-market prices. I
17 am pleased that Mr. Coats feels that CP&L has been able to purchase coal at
18 relatively good prices and I do concur that the price of coal has risen sharply over
19 the past two years. I note, however, that CP&L is a large purchaser of coal and,
20 therefore, should be able to get quite attractive prices for coal relative to smaller
21 purchasers of coal such as manufacturers that use relatively smaller amounts of
22 coal in their manufacturing process.

23
24 In CP&L's 2004 fuel case, the utility projected coal costs to average \$46.05 per
25 ton, inclusive of transportation. In the current fuel case, CP&L is forecasting coal
26 to average \$71.57 per ton, inclusive of transportation. This difference in forecasts
27 represents a stunning 55% increase in the forecasted cost of coal. When this
28 change is applied to CP&L's forecasted usage of coal, the increase in coal costs,
29 on a system-wide basis, is an equally stunning \$334 million per year. The sheer
30 size of this increase merits that the Commission proceed very cautiously in
31 accepting CP&L's forecasts in this proceeding.

1
2 **Q. DO YOU BELIEVE THAT CP&L HAS DONE EVERYTHING IN ITS**
3 **POWER TO MITIGATE THE INCREASE SOUGHT IN THIS CASE?**

4 A. No, I do not. There are two components in this fuel increase. The first component
5 seeks to recover past fuel expenses, which in this case is \$41 million. The second
6 component is a forecast of fuel costs that CP&L expects to incur in the period of
7 July, 2005 through June, 2006.

8
9 First, the utility erred in seeking recovery of this entire case in one single year. As
10 I have demonstrated above, CP&L's South Carolina service territory is
11 economically distressed as evidenced by the incredibly high unemployment as
12 noted in Table 2 above. Raising residential rates by 16% in any one given year
13 will be tough for any South Carolina residential consumer, particularly those that
14 live on fixed incomes. Raising industrial rates by roughly 27% may put some
15 manufacturers out of business. When a manufacturer leaves the state, CP&L and
16 its remaining business and residential consumers will suffer even further.

17
18 **Q. PLEASE EXPLAIN HOW CP&L AND ITS CUSTOMERS CAN BE HURT**
19 **BY THE UTILITY'S EFFORTS TO RECOVER ALL OF ITS**
20 **UNDERCOLLECTIONS IN A SINGLE YEAR?**

21 A. If, as I have opined above, manufacturers cut back or cease operations in South
22 Carolina as a result of the proposed 27% increase in the cost of electricity, CP&L
23 will suffer from a loss of revenues to the affected manufacturer. This loss of
24 revenues from industrial consumers will erode the utility's earnings and drive
25 down its stock price. Consumers will suffer because the costs otherwise paid by
26 the now shuttered manufacturer must be paid by the remaining consumers. As a
27 result, the erosion of revenues from the manufacturing sector will, in a vacuum
28 negate of other factors, drive CP&L to an earlier rate case than it would have
29 otherwise filed and permanently raise rates to all remaining customers.

1 Based on press reports, Progress Energy expenses are growing at a higher rate
2 than its income. If allowed to continue, expenses will, at some point in the future,
3 be larger than income thereby causing great financial distress to the utility. To
4 correct this problem, CP&L must either cut the rate of growth in its expenses or
5 increase its growth in income. Unfortunately, a 27% increase in rates will have
6 the exact opposite effect sought by the Company as such an increase will surely
7 cause all consumers, particularly manufacturers, to re-examine their use of
8 electricity and, possibly, cut back on such usage. A further decline in revenue
9 growth will hamper CP&L's financial health, as well as the economic health of
10 the Company's service territory.

11
12 **Q. DO YOU HAVE A RECOMMENDATION TO THE COMMISSION TO**
13 **MITIGATE SUCH RATE SHOCK?**

14 **A.** Yes. First of all, I recommend that the Commission allow an amount not greater
15 than CP&L's under-recovery of \$30 million of past fuel expenses as well as its
16 forecasted \$11 million in under-recovery through the end of the current test
17 period. The allowance of this \$41 million will raise residential rates by
18 approximately 6.8% and will also raise industrial rates by roughly 11.4%. These
19 rate increases are difficult to accept, but they will allow the utility to recover its
20 past fuel costs and maintain its financial integrity. This resolution is fair to the
21 Company and the State of South Carolina.

22
23 If CP&L's fuel increase is allowed to be passed on in the manner in which CP&L
24 is herein seeking, South Carolinians will suffer due to a sharp increase in power
25 costs. I believe that a 27% increase in the cost of electric service will undermine
26 public confidence in CP&L's rates and certainly constitutes an abrupt change to
27 consumers. Moreover, my recommendation in this matter is consistent with the
28 legislative intent of Section 58-27-865 of the South Carolina Code of Laws which
29 seeks to set rates in a way so as to assure public confidence and minimize abrupt
30 changes in charges to consumer.

1 **Q. DO YOU HAVE ANY FURTHER RECOMMENDATIONS IN THIS**
2 **CASE?**

3 Yes, I further recommend that, in the future, the Commission require CP&L to
4 file the following information, on a quarterly basis, with the Commission and
5 every party that was an intervenor in the Company's prior three fuel adjustment
6 proceedings:

- 7
- 8 • the fuel costs incurred to-date by the Company;
- 9 • a comparison of actual fuel costs incurred to-date relative to forecasted
- 10 fuel costs;
- 11 • a forecast of the Company's fuel costs through the end of the fuel test
- 12 year;
- 13 • if at each quarterly reporting period, the Company believes the forecasted
- 14 fuel factor is going to rise or fall at the end of the test year, provide a
- 15 comparison of the forecasted fuel costs expected in the coming fuel test
- 16 year versus the fuel costs derived using the fuel factor approved in the
- 17 most recent fuel proceeding.

18

19 This information is needed is so that the utility's consumers, particularly CP&L's
20 industrial consumers, can budget for large increases in their power bills.
21 Unfortunately, many manufacturers were unable to budget for the large increase
22 in costs that CP&L is now seeking from its consumers. A quarterly filing of this
23 fuel information will aid manufacturers in their budgeting process and will also
24 promote communications between the utility and all of its customers.

25

26 I further recommend that the Commission, through the Office of Regulatory Staff,
27 conduct a formal audit, over the course of the next year, of CP&L's purchasing
28 practices for fuel. This audit should, in my opinion, follow the same procedures as
29 outlined in the recent SCE&G fuel case final order.

1 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

2 **A. Yes, it does.**

3